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British Columbia Ferry Commission

Annual Report
for the Fiscal Year Ending March 31 2007

Prepared and submitted in accordance with
Section 53 of the Coastal Ferry Act
of the Province of British Columbia

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To the Lieutenant Governor in Council

Comox, B.C.
July 31st 2007

May It Please Your Honour:

BC Ferry Commission Annual Report
For the Fiscal Year Ending March 31 2007

I am pleased to submit to you the fourth Annual Report of the BC Ferries Commissioner.

As required by section 53 of the Coastal Ferry Act, the Report sets out briefly all applications and requests for decisions to the commissioner under the Act, all orders issued by the commissioner, the financial statements applicable to the office of the commissioner for the above period along with full disclosure of the expenses of, and associated with, the office of the commissioner.

Yours truly,

Martin Crilly
BC Ferries Commissioner

2008-03987/

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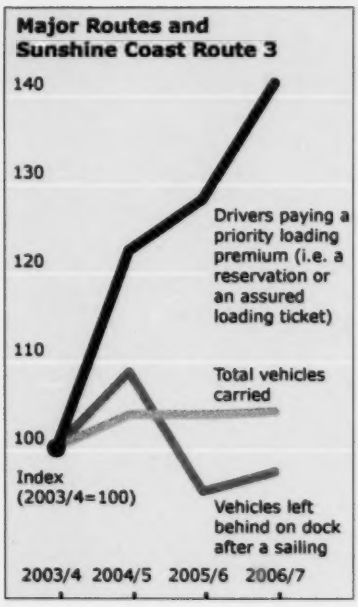
1 Highlights and Message from the Commissioners

This report covers the Commission's fourth year of operations under the Coastal Ferry Act. It was our busiest yet. While conducting our usual monitoring duties, we were active in two more areas: the restoration of ferry service in the north after a vessel was lost to sinking, and setting price caps for all route groups through the year 2012.

Overall contracted service level met except for the north

As in previous years, every three months we tracked the number of sailings that BC Ferries delivered, the quality of the service and the fares charged. Our examination indicates that, except on northern routes, as described later, BC Ferries again **substantially met its contractual obligation to provide core services for vehicles and passengers**.

Overall, BC Ferries operated its core services reliably, while maintaining its capacity and service frequencies at or above the minimum requirements and charging fares within the controlled maximums.



On-time performance shows an upward trend. The latest annual independent opinion poll indicates the customer satisfaction level remains high, holding past levels on some measures and improving on others.

On the three major routes over the last four years, the number of vehicles carried has been quite flat. So has the capacity provided: annual capacity utilization has levelled off at 68% for the past three years.

The number of car drivers paying for priority loading, available as an option on the three major routes and more recently on the Sunshine Coast route, using pre-paid reservations or assured loading tickets, has grown by over 40%, from about one-in-seven in 2003/4 to one-in-five in 2006/7[1].

Remarkably, we do not detect worsening service for those car drivers not choosing to pay the premium for priority, i.e. paying just the regulated rate. The annual count of "overload" vehicles, i.e. those left behind on the dock after a sailing departs, has fallen overall. Customers seem to be arriving at the toll booths in a way that more closely matches the capacity available. This may be attributable to demand management measures: BC Ferries has improved the information available to customers on when to expect congestion, offered steeper off-peak fare discounts and adjusted sailing schedules. Such measures may have helped smooth out traffic flow.

[1] Commission estimate based on BC Ferries' annual data

Authorizations after the loss of the Queen of the North

Special Decisions for Northern Routes
after loss of Queen of the North

In FY 2006/7 the Commission:

- authorized the reduction in summer core service after the loss of northern ferry capacity
- independently confirmed that BC Ferries' search for a replacement ship was thorough
- determined that BC Ferries' purchase of a used European ship was reasonably required with related terminal modifications.
- approved as reasonably required the accelerated purchase of a brand new northern vessel.

Following the tragic sinking of the **Queen of the North** just before the start of the year, we were asked to make several special decisions (see box, left) for northern services and capital investments.

Ferry customers in the north paid fares at levels unchanged by the sinking, but saw overall service levels fall even though BC Ferries redeployed its fleet and temporarily supplemented it using tug-and-barge and aircraft. The volume of traffic traveling on BC Ferries in the north dropped by one third.

We observe that BC Ferries and the Province negotiated a one-time downward adjustment in the Provincial service fee reflecting the net reduction in northern service. To support acquisition of two ships (one used, one new) that we approved for northern routes, BC Ferries also secured a sizeable increase in Provincial service fees for this and future years.

These northern developments were but some of the considerations in our **preliminary price cap decision** for all route groups **for performance term two**, the four years ending in 2012, issued at year-end.

Our ruling contains an inflation–related formula under which BC Ferries could raise fares considerably faster than the increase in the consumer price index through 2012. We built into the price caps a challenge to the company to improve its overall productivity by 1% annually. Even so, our ruling means, on average over the four years of performance term two, that fares could climb at up to two times the rate of general inflation on the major route group, and up to three times on the other "non major" ones.[2]

Why fare caps exceed inflation

Behind these relatively rapidly rising price caps are certain realities:

- underlying costs of ferry service are climbing due to general inflation in the cost of labour, fuel and maintenance;
- on top of this, BC Ferries is in a catch-up phase of accelerated renewal of its ships and terminals with which we concur;
- the backlog of extra fuel costs paid by BC Ferries (not expected to be recovered by fuel surcharges by March 2008) are to be recovered from ferry customers in future; and
- on the six 'non-major" route groups, government contributions are growing, but not as fast as BC Ferries' total revenue needs, even when the Province's higher funding for the north, mentioned above, and a contribution to pay down the fuel cost backlog, are counted. Faster growth in fare revenue must bridge the gap between the growth rate of revenues and government contributions. This explains in part the faster-climbing price cap for the non-major groups versus the major group, which receives no taxpayer funding and is not subject to this effect.

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[2] On April 1, 2008 caps would rise by 5.4% on the three major routes and 3.6% on all other routes. Increases for April 1 2009, 2010 and 2011 are linked by formula to CPI inflation: for example, if inflation were 2% through 2011, the formula lifts caps each year by 3% on the major routes and 6.7% on others.

Wider impacts not considered

While working on our preliminary price cap decision, and in the period following for public input, we were careful to correct popular misconceptions: that the Commission determines user pay policy, that it controls the amount of taxpayer funding, that it weighs the impact of fare increases on ferry-dependent communities or their affordability to customers, and that it regulates ferry services mindful of any social and economic goals to shape land use and settlement patterns on the islands.

Why increases are the same for the six non-major route groups

We underscore a feature of the ruling: the rate of increase in the price caps is the same for the six non-major route groups. This is because, prior to our ruling, the Province and BC Ferries provided a signed statement of intent to amend their Coastal Ferry Services Contract to reallocate service fees among the six "non-major" route groups so that they would see identical rates of increase in performance term two. Subsequently, we did receive a formal contract amendment to this effect. Without it, the rates of increase for the six groups would have been quite different from each other.

Fuel surcharges and their future

Fuel prices remained unexpectedly high through the year. Mid-year, we increased fuel surcharges (see box, left). By year end, fuel prices seemed unlikely ever to return to levels of four years earlier. For performance term two we folded fuel surcharges into the base fare. Hence the base for the above percentage increases in price caps is the fare level, including fuel surcharges, in effect at the end of performance term one.

Fuel Surcharge Adjustments

- In June 2006, we authorized a fuel surcharge of 3.2% for major routes and 9.6% for most of the other route groups.
- In spring 2007, we adjusted downwards fuel surcharges on two routes.

There will still be fuel related adjustments up and down in fare caps in performance term two. A new fuel price adjustment on fare caps will begin in performance term two, under which BC Ferries and its customers will, in part, share the cost (or benefit) of fuel price fluctuations within a price band.

Last year we set a fuel conservation target for BC Ferries through March 2008 and required the company to show a fuel conservation plan. It did so and has since reported that it is meeting or exceeding the target.

Federal tax relief for commuters

Some commuters may see relief through a **Federal income tax credit**. This would effectively reduce the cost of commuter passes by 15%. We have urged BC Ferries to offer customers a fare that qualifies (none does at the moment) and to bring forward the necessary systems. The company has said it sees the desirability of establishing a suitable product and is seeking guidance from the Federal Department of Finance. Customers may need to accept a more rigorous means of recording usage if they wish to benefit.

Service delivery is stable: capital funding for renewal is accessible

The Coastal Ferry Act and Coastal Ferry Services Contract, plus exclusive-use terminal leases, effectively shield BC Ferries from competition. Under this framework, since 2003, apart from a labour-management disruption in the first year, by most measures core ferry services have been stable, reliable and of sustained or improving quality. Through the bond market, BC Ferries has successfully found external financing for capital renewal and expansion as needed.

Productivity and innovation.

A question mark remains, however, concerning efficiency: will **significant productivity gains and innovation** be forthcoming, and how? Other than in the commercial truck market on major routes, where two rival firms operate, there is little prospect of serious competition, which we think

is an important driver of efficiency and innovation. These two are key to keeping down fares and subsidies in the future.

Certain incentives do exist: our regulatory system allows the firm to keep surpluses earned during a performance term, which should promote cost-awareness; management has an incentive pay scheme linked to performance; and section 69 of the Act gives the Commission a way to encourage BC Ferries to seek out cost-effective alternative service providers to meet its service obligations.

Section 69 yet to work

The Act's **alternative service delivery** clauses have yet to achieve their intended effect. The original plan for performance term one was to seek subcontractors for six routes, representing 13% of BC Ferries cost base for core services. The execution of the plan has been slow for a number of reasons, some of them beyond BC Ferries' control.

Currently, BC Ferries is evaluating responses to its competitive tender request for proposals on one of these routes (Mill Bay-Brentwood Bay); and, with our encouragement, is working with a potential alternative service provider on a possible pilot project for two routes (Hornby and Denman Islands) which were not part of the original plan. These three routes together represent less than 2% of BC Ferries' cost base.

Redefining core service

Our annual report last year indicated another possible avenue to improved productivity: **redefining core service**—i.e. what routes are served, with how much service—to better match (a) the changing travel needs of communities and/or (b) BC Ferries' changing delivery capabilities. We noted minor adjustments (e.g. of schedules) already made, but thought more substantial ones might be justifiable under Provincial policy.

The latest contract amendment of June 2007 gives BC Ferries new flexibility on most routes to shift some sailings from times of relatively lower towards higher demand, while keeping the total annual number of sailings unchanged. This is a positive step towards cost-effectiveness and we look forward to seeing how BC Ferries uses this limited freedom.

We will endeavour to keep BC Ferries eager to identify and test similar ideas with the Province in future. We fully respect the responsibility of the Province to establish public policy on what communities should have taxpayer-supported ferry service, during what hours and of what capacity; but we note that, in each of the past three years on the minor route group, capacity utilization averaged just 45% year-round, with much lower percentages in off-peak periods.

Respectfully submitted,

Martin Crilly
BC Ferries Commissioner

Alan Eastwood
Deputy BC Ferries Commissioner

July 31, 2007

2 The Role of the Commission

Policy Principles for the BC Ferry Commission
Coastal Ferry Act, s 38

(a) priority is to be placed on the financial sustainability of the ferry operators;
(b) ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery;
(c) ferry operators are to be encouraged to seek additional or alternative service providers on designated ferry routes through fair and open competitive processes;
(d) ferry operators are to be encouraged to minimize expenses without adversely affecting their safe compliance with core ferry services;
(e) cross subsidization from major routes to other designated ferry routes is (i) to be eliminated within the first performance term of the first Coastal Ferry Services Contract to be entered into under this Act, and (ii) before its elimination, to be minimized;
(f) the designated ferry routes are to move towards a greater reliance on a user pay system so as to reduce, over time, the service fee contributions by the government.

The **BC Ferry Commission** regulates ferry operators under the Coastal Ferry Act of 2003. The Province appoints the commissioner and up to two deputy commissioners as statutory officers for six- to eight-year terms. They are independent of both the government and of ferry operators. In August 2003 Martin Crilly of Comox was appointed Commissioner. In September 2004, Alan Eastwood of North Saanich was appointed Deputy Commissioner.

Their decisions cannot be appealed, except on a question of law. They may be terminated only for mental infirmity, conviction for an indictable offence under Canada's criminal code, or a judicial finding of conflict of interest or material breach of duties or obligations.

The Commission is not an ombudsperson acting to resolve any private disputes with ferry operators; nor is it a general complaints or compliments bureau. Further, it is not responsible for regulating safety or environmental impacts of ferry operations.

In exercising its powers as watchdog, the Commission is obliged to follow six policy principles in protecting the public interest (see box, left).

BC Ferries was created in April 2003 from the former BC Ferry Corporation, which was a taxpayer-supported crown corporation. It is now a self-financing company with a mandate to widen travel choices for users and improve service quality.

Under a long-term contract with the Province, BC Ferries must operate its system to provide defined **minimum core service levels** on each of the 25 routes. On three of them, called **major routes,** which are financially self-sufficient, BC Ferries receives no subsidy. On the other 22, the government pays BC Ferries a **ferry transportation fee** per-round trip sailing.

One of the Commission's tasks is to **regulate ferry fares**. The Commission sets a ceiling or "price cap" on the average level of fares which BC Ferries can charge. The goal in setting the price cap is to balance consumer protection with financial sustainability of the ferry operator, while encouraging efficiency.

The routes are divided into seven geographic groups. Each group has its own price cap, which is a ceiling on the weighted average level of the

individual fares within the group. The level is re-set after every fourth year. Each four year[3] period is termed a "performance period". In its surveillance of ferry fares, the Commission ensures that the weighted average of ferry fares, for each of seven groups of routes, does not rise above the cap for each group. If it does, the Commission may penalize the operator unless corrective action, e.g. reducing fares, is taken within the next quarter.

Regulation of service quantity

In overseeing the amount or **quantity of service** provided by BC Ferries, the Commission monitors the adherence of BC Ferries to the terms of its service contract with the Province. The Commission checks that the numbers of sailings on each route are at a minimum equal to those required in the service contract, subject to an allowance for missed sailings for certain reasons (e.g. bad weather). If there is a shortfall in the quantity of service the operator sacrifices the service fee and may face other more serious consequences.

Regulation of service quality

While the broader and less readily measured performance parameter of **service quality** (e.g. punctuality, reliability, comfort and convenience to customers, or other qualitative dimensions of ferry service) are of great import to ferry customers, the Commission does not try to regulate in this area. To do so would be difficult, inconsistent with the legislature's intention that regulation be exercised in a light handed fashion.

However, the Commission does track BC Ferries' regular reports of its on-time performance, and the number of "overload" sailings which depart leaving customers behind in the waiting area. The Commission also inspects regular customer satisfaction sampling surveys which BC Ferries is contractually bound to carry out using an outside polling firm.

Pro-competitive regulation

Although BC Ferries has weighty service obligations, it also enjoys **privileges as a near-monopoly**. It has exclusive use of terminals, which are facilities of major strategic and competitive importance to an operator. On 22 of its routes (those other than the three major routes), BC Ferries is the sole recipient of taxpayer support. The company is also income-tax exempt. It has the advantages of a large, incumbent operator with flexibility in vessel deployment, able to take advantage of economies of scale and network coverage. These give the company a low risk profile from the investors' perspective and result in a comparatively low cost of borrowing.

These advantages are intended by the legal and contractual framework, but they largely **protect BC Ferries from meaningful competition**. There are few existing competitors against whom to benchmark BC Ferries. The market and regulatory structure does not foster the emergence of such competitors in future.

In this context, to promote **efficiency**—which helps keep down both ferry fares and the need for taxpayer funding—the Commission's rulings aim to provide incentives to BC Ferries to deliver ferry service in an

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[3] Except for the first performance period, which is five years, ending on March 31, 2008.

efficient fashion while maintaining the required priority on its financial sustainability.

The Coastal Ferry Act requires BC Ferries, in each performance period, to submit to the Commission a plan to **seek additional or alternative service providers** (ASPs)—and then to execute that plan. ASPs could **serve on BC Ferries routes under subcontract**, if they could reduce the costs of ferry operations. The Commission sees this clause, in part, as guarding against the danger of BC Ferries, in the absence of little other competition, becoming complacent about its own methods and cost-efficiency. The Act empowers the commission to penalize BC Ferries if it considers that BC Ferries has not submitted a satisfactory plan, and to order it to submit one and to execute it—to a deadline.

Commission probes

Overall, the Commission is alert for information, either from its own observations or from the public, suggesting how the performance, service quality, efficiency or productivity of ferry operations could be improved. The Commission may decide to launch a probe on any topic of interest to it, in which the ferry operator is legally required to answer the Commission's questions and comply with any resulting orders, with no appeal.

3 Activity Summary

Commission Activities in the fiscal year 2006/7

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1. **Regulation of Ferry Fares**
   - confirmed actual fares were below the caps during the year
   - approved one increase in fuel surcharges
   - issued a preliminary decision on price caps for performance term two (2008-2012)

2. **Regulation of Service Levels**
   - confirmed that BC Ferries delivered contracted round-trips
   - allowed service reductions through summer 2006 following the loss of the Queen of the North

3. **Special Decisions**
   - declared that acquisition of two northern ships, plus related terminal modifications, are reasonably required
   - gave direction on procurement of alternate service providers

4. **Enforcement**
   - monitored BC Ferries public reporting

5. **Publication and Outreach**
   - maintained records, published decisions, and communicated with the public and stakeholders.

6. **Administration and Reporting**
   - operated an office, obtained support services and consulting advice.

The Commission's activities fall into **six headings** shown on the left. These headings are taken from the Commission's Service Plan and Budget for the year ending March 31 2007, published in September 2005. The core, ongoing activities are in headings 1 and 2: the **regulation of fares** through the price cap mechanism, and the **regulation of service levels**.

Special decisions under heading 3 include pre-approval of major capital deployments (e.g. new ships), and overseeing the search for alternate service providers. The Commission found no reason to undertake **enforcement** action (under heading 4).

Two further activity areas were to inform the public about the Commission's role (under heading 5 - **publication and outreach**) and maintaining routines and procedures under **administration and reporting** under heading 6.

Readers will find **more detail** in the table on the following pages. It lays out the Commission's **planned versus actual activities** under the same headings, keyed to the relevant section number of the Coastal Ferry Act.

4 Activity Detail

This section takes the list of the planned Commission activities from its Service Plan and offers a detailed description of actual activities.

Activity number	Coastal Ferry Act Section	Activity Description copied from our Service Plan for 2006/7 which was published in September 2005	Actual Activity in Fiscal 2006/7
1.0		**Regulation of Ferry Fares**	
1.1	39	Monitor how weighted average price is calculated The Commission will monitor the functioning of the Average Fare Model. This was developed in collaboration with BC Ferries in 2003/4 as the key measuring tool for judging whether BC Ferries' weighted average fares are within the price cap established by the Commission. The model requires adjustment and improvement (e.g. for changes in type and quality of source data) and cross-checking from time to time. Where necessary, the operation of the model will be externally validated.	We considered various observations and concerns offered by BC Ferries on the behaviour and usefulness of the Average Fare Model, but made no changes in the methodology
1.2	38,65	Review BCF quarterly reports on price level The Commission will specify contents required in BC Ferries quarterly reports respecting fare levels for each route group. The Commission will determine if the weighted average of the tariffs charged for each route group, as measured using the above Average Price Model are within the price cap established, and if not make appropriate orders.	We reviewed BC Ferries quarterly reports comparing the actual weighted average fare for each route group with the price cap for that group. We found the company in compliance.
1.3	42	Handle any BCF applications for extraordinary price increases The Commission will review and consider applications by the ferry operator for extraordinary tariff price cap increases, for example due to	On June 19, 2006, following higher fuel prices experienced since December 2005 and forecast through 2008, our Order 06-03 authorized higher fuel surcharges on BC Ferries fares effective June 22, 2006, using a formula given in our previous fuel surcharge decision of January 20, 2006. As a percentage of fares, the increase in fuel surcharges was 3.2% for major routes and 9.6% for other route groups (except for Mill Bay-Brentwood Bay and Langdale-Gambier-Keats, which saw no increase). When added to existing surcharges, this translated, for example, to a total surcharge

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1.3	42	Handle any BCF applications for extraordinary price increases	
		The Commission will review and consider applications by the ferry operator for extraordinary tariff/price cap increases, for example due to	On June 19, 2006, following higher fuel prices experienced since December 2005 and forecast through 2008, our Order 06-03 authorized higher fuel surcharges on BC Ferries fares effective June 22, 2006, using a formula given in our previous fuel surcharge decision of January 20, 2006. As a percentage of fares, the increase in fuel surcharges was 3.2% for major routes and 9.6% for other route groups (except for Mill Bay-Brentwood Bay and Langdale-Gambier-Keats, which saw no increase). When added to existing surcharges, this translated, for example, to a total surcharge:

		extraordinary increases in the price of fuel.	on the major routes, of 80 cents for passengers and $2.85 cents for under-height vehicles; on a typical smaller inter-island route, 45 cents each way for passengers and from $1.20 each way for under-height vehicles; and on northern routes that have significantly longer travel distances, ranging up to $18.30 for passengers and $36.55 for under-height vehicles on the Port Hardy - Bella Coola route. We issued an 11-page Backgrounder on Fuel prices and Surcharges. As requested in our earlier Order 05-06, on June 15, 2006 BC Ferries presented a 16-page Fuel Savings Plan showing how the company intends to reduce fuel volume burned by 1% each year through March 2008.
1.4	45	Adjust price cap for any service cuts/route discontinuances	
		The Commission will review service reductions or discontinuance of routes for impact on price cap and make appropriate adjustments in price cap.	Applications for route discontinuance were allowed from October 2006 under the Coastal Ferry Services Contract between BC Ferries and the Province of BC. We received none, and so no adjustments were considered in the price cap. There were service reductions in the north following the sinking of the Queen of the North. We made no reductions in the northern price cap. We note that the Province and BC Ferries negotiated a reduction in service fees for the northern routes in respect of this period.
1.5	40,41	Conduct price cap review for next performance term	
		The Commission will initiate on or before October 1 2006 a price cap review for second performance term, i.e. for the period April 1, 2008 – March 31, 2012 Price caps provide a ceiling for the fares that BC Ferries is allowed to charge its customers	The price cap review for the second performance term began in FY 2006/7. The review was the main topic addressed in some 18 meetings between the Commission and with BC Ferries and its consultants during the year, held mainly at BC Ferries head office in Victoria. The Coastal Ferry Act section 41(2)(b) obliges us to establish an appropriate return on equity for BC Ferries. Our Memorandum 20 of September 17 2006, supported by the advice of an independent consultant, made a preliminary ruling of 14% p.a. for BC Ferries' before-tax return on equity. As required by the Act, by September 30 2006, BC Ferries made a 172-page Performance Term Two Submission to the Commission with operational and financial data, historical and forecast, for use in our review. We engaged consultants to help analyse and assess this submission, and released it to the public on November 21 2006. On March 30, 2007 we made our Preliminary Decision that on April 1, 2008 fares could increase by 5.4% on the three major routes and 3.6% on all other routes. The starting point for these increases is the fare level, including fuel surcharges, that will be in effect March 31 2008; that is, the fuel surcharges will be folded into the fare base. Prior to this, in spring 2007 fuel surcharges on two routes (Langdale-Horseshoe Bay and Mill Bay-Brentwood Bay) will be adjusted downwards. Annual fare cap increases for April 1 2009, 2010 and 2011 are linked to general inflation: if inflation were 2% through 2011, fares could then increase each year by 3% on the major routes and 6.7% on the other routes. We also issued a companion memorandum to our preliminary decision with a description of a new automatic adjustment mechanism for fuel surcharges/rebates

			responding to changes in fuel prices from 2008 to 2012. We issued a 15-page set of Questions and Answers explaining our preliminary decision and its background and explaining how the public could provide input. We invited comments to the Commission by June 30 2007 on the preliminary decision. Under the timeline in the Coastal Ferry Act,the Province and BC Ferries have three months, to June 30, 2007, to make any changes to their Coastal Ferry Services Contract, which could in principle involve changes in ferry service and changes in taxpayer funding. Following that date, the Commission will make any needed adjustments and issue a final ruling on fare caps for the 2008 – 2012 contract term by September 30, 2007.
2.1	38,65	Review BCF quarterly reports on service level	
		The Commission will specify the format of, and review quarterly reports of BC Ferries as the ferry operator to determine if it is meeting the contract service requirements.	We reviewed BC Ferries quarterly reports on on-time performance, overloads, and sailings provided relative to contract.
2.2	38,66	Review BCF annual reports on service level	
		The Commission will specify the format of, and review annual reports of BC Ferries as the ferry operator to determine if it is meeting the contract service requirements. It will also review BC Ferries' annual customer satisfaction survey, which BC Ferries must provide to the Commission under the terms of the Coastal Ferry Services Contract.	We engaged a consultant to assist in reviewing BC Ferries annual report made in July 2006, and reviewed the annual customer satisfaction survey.
2.3	43	Handle any BCF applications for service reductions	
		Review and consider any applications by the ferry operator for reductions in service (temporary reductions would occur immediately)	We made several rulings authorizing and extending service reductions in the north through summer 2006, following the sinking of the Queen of the North on March 22 2006. On April 24 2006 we authorized the northern service reduction following an April 10 2006 application by BC Ferries. Our Order 06-01 formally recognized, as being both temporary and extraordinary, a reduction of service on BC Ferries' northern routes, through May 18, 2006. This Order was essentially technical. Section 43 of the Coastal Ferry Act states that if BC Ferries "wishes to reduce service on a designated ferry route below the core ferry services required for that designated ferry route (it) must make application to the commissioner for the authorization ... and must, in that application, justify the requested reduction." On April 24, BC Ferries released its plans for reduced service on the northern routes starting May 18 for the summer of 2006. In a letter of May 10, 2006 BC Ferries advised us of its efforts to obtain a suitable replacement vessel for the Queen of the North and stated its conclusion that it was unlikely that a replacement vessel will be available for service on the two routes for summer 2006. Accordingly we issued Order 06-02 extending the date of the reduction in service by 60 days from May 18, during which time we reviewed information from BC Ferries regarding its search for a replacement vessel. In June we

			engaged an independent consultant to advise on this review. After an independent examination, in a consultant's report on BC Ferries' search to replace the Queen of the North, we stated that we were satisfied that BC Ferries had made a thorough search for a suitable replacement vessel in a systematic and competent manner. On July 14, 2006 we authorized, as both temporary and extraordinary, through to the end of the summer season (September 30 2006) the reduction in service in the north previously allowed in Order 06-02 only to July 16, 2006. BC Ferries already had adequate vessel capacity to provide the lower core levels of winter service to the north starting October 2006 using the Queen of Prince Rupert. The acquisition of a used vessel (see below, under section 55 of the Act) would help BC Ferries to re-establish its contracted higher core service levels in summer 2007.
2.4	44	Handle any BCF applications for route discontinuance, possibly hold hearing	
		Review and consider any applications by the ferry operator to discontinue a route. After October 2006, route discontinuance applications may be made (the determination process takes 9 months).	Route discontinuance is allowed from October 2006 but no application was made.
3.1	55	On ferry operator's request, decide if a proposed capital deployment is reasonable	
		If a ferry operator makes an application, the Commissioner will consider a proposed capital deployment or capital expenditures in connection with a route or terminal to determine if they are reasonably required. Consultants of various specialties will be engaged to undertake a "process audit" of the BC Ferries analysis.	After a worldwide search BC Ferries identified a suitable used vessel, available for immediate purchase, which could be deployed to rebuild service levels on northern routes in 2007, following the reduction in service resulting from the sinking of the Queen of the North in March 2006. BC Ferries stated that after an extensive search of the used vessel market, including the review of close to 100 vessels, most were eliminated because they did not meet stability requirements, operational requirements such as length, draft, beam, speed, or were in poor condition. After an application by BC Ferries for a ruling, in Order 06-04 we declared this used vessel to be reasonably required. This meant that we would recognize the cost of the vessel when setting fare caps in the north for BC Ferries' second performance term starting April 1, 2008. In our ruling we alerted BC Ferries that insurance proceeds from the loss of the Queen of the North may be taken into account in setting these fare caps, in a manner to be approved by us. On July 14 2006 BC Ferries asked for a Commission declaration that a newly built replacement vessel for northern routes is reasonably required. BC Ferries informed us that before the loss of the Queen of the North in March 2006, its negotiations with the Province (which provides taxpayer support for northern routes through service fees) had confirmed the requirement to replace the northern vessels in the following years: the Queen of Prince Rupert in 2009, the Queen of the North in 2010, and the Queen of Chilliwack in 2011. However, as a result of the loss of the Queen of the North, BC Ferries reported that it agreed with the Province to advance this vessel replacement schedule to resume service on

responding to changes in fuel prices from 2008 to 2012.

We issued a 15-page set of explaining our preliminary decision and its background and explaining how the public could provide input. We invited comments to the Commission by June 30 2007 on the preliminary decision.

Under the in the Coastal Ferry Act,the Province and BC Ferries have three months, to June 30, 2007, to make any changes to their Coastal Ferry Services Contract, which could in principle involve changes in ferry service and changes in taxpayer funding. Following that date, the Commission will make any needed adjustments and issue a final ruling on fare caps for the 2008 – 2012 contract term by September 30, 2007.

2.0	**Regulation of Ferry Service Levels**		
2.1	38,65	Review BCF quarterly reports on service level	
		The Commission will specify the format of, and review quarterly reports of BC Ferries as the ferry operator to determine if it is meeting the contract service requirements.	We reviewed BC Ferries quarterly reports on on-time performance, overloads, and sailings provided relative to contract.
2.2	38,66	Review BCF annual reports on service level	
		The Commission will specify the format of, and review annual reports of BC Ferries as the ferry operator to determine if it is meeting the contract service requirements. It will also review BC Ferries' annual customer satisfaction survey, which BC Ferries must provide to the Commission under the terms of the Coastal Ferry Services Contract.	We engaged a consultant to assist in reviewing BC Ferries annual report made in July 2006, and reviewed the annual customer satisfaction survey.
2.3	43	Handle any BCF applications for service reductions	
		Review and consider any applications by the ferry operator for reductions in service (temporary reductions would occur immediately)	We made several rulings authorizing and extending service reductions in the north through summer 2006, following the sinking of the Queen of the North on March 22 2006. On April 24 2006 we authorized the northern service reduction following an April 10 2006 application by BC Ferries. Our Order 06-01 formally recognized, as being both temporary and extraordinary, a reduction of service on BC Ferries' northern routes, through May 18, 2006. This Order was essentially technical. Section 43 of the Coastal Ferry Act states that if BC Ferries "wishes to reduce service on a designated ferry route below the core ferry services required for that designated ferry route (it) must make application to the commissioner for the authorization ... and must, in that application, justify the requested reduction." On April 24, BC Ferries released its plans for reduced service on the northern routes starting May 18 for the summer of 2006. In a letter of May 10, 2006 BC Ferries advised us of its efforts to obtain a suitable replacement vessel for the Queen of the North and stated its conclusion that it was unlikely that a replacement vessel will be available for service on the two routes for summer 2006. Accordingly we issued Order 06-02 extending the date of the reduction in service by 60 days from May 18, during which time we reviewed information from BC Ferries regarding its search for a replacement vessel. In June we

engaged an independent consultant to advise on this review.

After an independent examination, in a consultant's report on BC Ferries' search to replace the Queen of the North, we stated that we were satisfied that BC Ferries had made a thorough search for a suitable replacement vessel in a systematic and competent manner.

On July 14, 2006 we authorized, as both temporary and extraordinary, through to the end of the summer season (September 30 2006) the reduction in service in the north previously allowed in Order 06-02 only to July 16, 2006.

BC Ferries already had adequate vessel capacity to provide the lower core levels of winter service to the north starting October 2006 using the Queen of Prince Rupert. The acquisition of a used vessel (see below, under section 55 of the Act) would help BC Ferries to re-establish its contracted higher core service levels in summer 2007.

2.4	44	Handle any BCF applications for route discontinuance, possibly hold hearing	
		Review and consider any applications by the ferry operator to discontinue a route. After October 2006, route discontinuance applications may be made (the determination process takes 9 months).	Route discontinuance is allowed from October 2006 but no application was made.

3.0 Special Decisions

3.1	55	On ferry operator's request, decide if a proposed capital deployment is reasonable	
		If a ferry operator makes an application, the Commissioner will consider a proposed capital deployment or capital expenditures in connection with a route or terminal to determine if they are reasonably required. Consultants of various specialties will be engaged to undertake a "process audit" of the BC Ferries analysis.	After a worldwide search BC Ferries identified a suitable used vessel, available for immediate purchase, which could be deployed to rebuild service levels on northern routes in 2007, following the reduction in service resulting from the sinking of the Queen of the North in March 2006. BC Ferries stated that after an extensive search of the used vessel market, including the review of close to 100 vessels, most were eliminated because they did not meet stability requirements, operational requirements such as length, draft, beam, speed, or were in poor condition. After an application by BC Ferries for a ruling, in Order 06-04 we declared this used vessel to be reasonably required. This meant that we would recognize the cost of the vessel when setting fare caps in the north for BC Ferries' second performance term starting April 1, 2008. In our ruling we alerted BC Ferries that insurance proceeds from the loss of the Queen of the North may be taken into account in setting these fare caps, in a manner to be approved by us. On July 14 2006 BC Ferries asked for a Commission declaration that a newly built replacement vessel for northern routes is reasonably required. BC Ferries informed us that before the loss of the Queen of the North in March 2006, its negotiations with the Province (which provides taxpayer support for northern routes through service fees) had confirmed the requirement to replace the northern vessels in the following years: the Queen of Prince Rupert in 2009, the Queen of the North in 2010, and the Queen of Chilliwack in 2011. However, as a result of the loss of the Queen of the North, BC Ferries reported that it agreed with the Province to advance this vessel replacement schedule to resume service on

			the Northern Routes as early as possible. Accordingly, BC Ferries focused on two parallel initiatives: a search of the used vessel market, and accelerating the acquisition schedule for the new vessels. On August 14 we found the new vessel to be reasonably required in Commission Order 06-06, which includes a 6-page review of BC Ferries' application and the reasons for the ruling. At the same time we directed BC Ferries to keep open the options for alternative service providers (ASPs) to own and/or operate the new northern vessel (see our task 3.3 under section 69 of the Act, below). Our related Order 06-07 dated September 17 2006 found that BC Ferries proposed expenditures of $33.4 million on northern terminals to accommodate the above-mentioned new northern vessel were reasonably required, meaning the Commission will recognize their costs in setting fare caps for the north for the second performance term starting April 1 2008.
3.2	38(4)	Deregulate a ferry route if competition sufficient	
		Make a determination of removing the route designation for a route upon which sufficient competition exists so that regulation of that route is no longer necessary.	As a guest of Seaspan Intermidal,[Intermodal ?] a competing carrier of trucks across Georgia Strait, the Commissioner travelled onboard a Seaspan vessel from Tilbury Island to Nanaimo and discussed competition issues and concerns with Seaspan management. There was no other activity in this area.
3.3	69	Review BC Ferries Plan to Seek Alternate Service Providers	
		Monitor the market for ferry services with a view to encouraging competition for BC Ferries; monitor BC Ferries implementation of its Additional and Alternate Service Providers Plan (supplemented in August 2005) to provide service on BC Ferries designated routes by subcontract, franchise, or other means.	Just before the beginning of FY 2006/7, in March 2006, we agreed that BC Ferries could amend its approach to procuring alternative service providers (ASPs), and move to a conventional subcontracting model. We agreed that two features of BC Ferries' ASP Plan Supplement of August 2005 - fairness auditors and a Chinese wall – were not necessary. We stated that external reviews of key subcontracting decisions will be essential, so that we can satisfy ourselves that ASP selection criteria and evaluation are unbiased and not slanted towards BC Ferries. We also observed that BC Ferries may have closed the door too tightly on unsolicited proposals to operate its ferry routes. In July 2006, in our FY 2005/6 Annual Report, we observed that: - the Coastal Ferry Act's alternative service delivery clauses had yet to achieve their intended effect; - few ASPs had shown sustained interest in providing service, that some may be deterred by challenges they see in the business model; - to minimize its risks, BC Ferries has set the qualifying hurdles for ASPs understandably high and that we had difficulty discerning whether and, if so, how much these concerns are amplified by an understandable reluctance to relinquish a significant portion of its in-house core operation. In August 2006, in conjunction with our ruling that a newly built vessel for northern service is reasonably required, we directed BC Ferries to: - keep the alternative service provider (ASP) proponent who continues to express interest in delivering service in the north fully and regularly informed as shipyard negotiations resume on a new northern vessel

			- detail its proposed approach to alternative service delivery procurement and then seek the Commission's endorsement of key features and timelines; and - provide, for our review, by November 15 2006, proposals for ensuring that alternative service provider(s) are given an opportunity to own and/or operate the newly acquired vessels in the north. On November 2 2006, BC Ferries responded to our direction in part as follows: - BC Ferries has taken steps to ensure that ASPs are given an opportunity to own and/or operate the two newly acquired vessels. - BC Ferries anticipates as owner of the Northern Adventure that it will be in a position to sell or dispose of it (e.g. to an ASP) as would any owner, subject to the provisions of its Master Trust Indenture (with a consortium of lenders). - With respect to the new-build vessel for the north, there is a clause in its construction contract which permits BC Ferries as buyer to assign the contract to a third party (e.g. an ASP). - BC Ferries was reviewing its original ASP process and timelines ...on the northern routes. Discussions are presently underway with the Province in respect of requirements for route 40.....as such BC Ferries proposed to defer submission of its update on the northern ASP process... The company has since stated that it expects to issue a Request for Proposals regarding routes north of Port Hardy, but the timing is uncertain. At year end, with our encouragement, BC Ferries was working with a potential ASP regarding a possible pilot project for the Denman and Hornby Island routes.
4.1	38(2)	Monitor BCF reporting to public	
		The Commissioner will observe how BC Ferries reports its own performance respecting pricing its fares under the price cap, and respecting its service level actually delivered versus the contracted service levels.	BC Ferries issues tariffs in print and on the world wide web, while the Commission publishes average fare levels compared with price caps for regulatory purposes. We observe that BC Ferries own reporting of its on-time performance has become more detailed. In April 2006 we made a detailed review of BC Ferries' Annual Report to the Commission for FY 2004/5. We put six questions about the report to BC Ferries. The company responded June 2, 2006 with a restatement of the financial reports on individual routes. The restatement did not affect the reported performance of the routes taken as a total. We published details of this under "probes" on our website.
4.2	46	Inspect BCF records as required	
		Order inspections of the records of the ferry operator as necessary	No activity was necessary.
4.3	48	Issue orders to BCF re: non-compliance with the law as required	

- detail its proposed approach to alternative service delivery procurement and then seek the Commission's endorsement of key features and timelines; and
- provide, for our review, by November 15 2006, proposals for ensuring that alternative service provider(s) are given an opportunity to own and or operate the newly acquired vessels in the north.

On November 2 2006, BC Ferries responded to our direction in part as follows:

- BC Ferries has taken steps to ensure that ASPs are given an opportunity to own and or operate the two newly acquired vessels.
- BC Ferries anticipates as owner of the Northern Adventure that it will be in a position to sell or dispose of it (e.g. to an ASP) as would any owner, subject to the provisions of its Master Trust Indenture (with a consortium of lenders).
- With respect to the new-build vessel for the north, there is a clause in its construction contract which permits BC Ferries as buyer to assign the contract to a third party (e.g. an ASP).
- BC Ferries was reviewing its original ASP process and timelines ...on the northern routes. Discussions are presently underway with the Province in respect of requirements for route 40.....as such BC Ferries proposed to defer submission of its update on the northern ASP process.

The company has since stated that it expects to issue a Request for Proposals regarding routes north of Port Hardy, but the timing is uncertain.

At year end, with our encouragement, BC Ferries was working with a potential ASP regarding a possible pilot project for the Denman and Hornby Island routes.

4.0	**Enforcement**		
4.1	38(2)	Monitor BCF reporting to public	
		The Commissioner will observe how BC Ferries reports its own performance respecting pricing its fares under the price cap, and respecting its service level actually delivered versus the contracted service levels.	BC Ferries issues tariffs in print and on the world wide web, while the Commission publishes average fare levels compared with price caps for regulatory purposes. We observe that BC Ferries own reporting of its on-time performance has become more detailed. In April 2006 we made a detailed review of BC Ferries' Annual Report to the Commission for FY 2004 5. We put six questions about the report to BC Ferries. The company responded June 2, 2006 with a restatement of the financial reports on individual routes. The restatement did not affect the reported performance of the routes taken as a total. We published details of this under "probes" on our website.
4.2	46	Inspect BCF records as required	
		Order inspections of the records of the ferry operator as necessary.	No activity was necessary.
4.3	48	Issue orders to BCF re: non-compliance with the law as required	

		Issue orders for non-compliance with the legislation as necessary	No activity was necessary.	
5.0		**Publication and Outreach**		
5.1	52	Maintain Commission records, provide public access		
		Files will be maintained accessible to the public under the Freedom of Information and Protection of Privacy Act. Response to public enquiries will be made via telephone, postal mail, e-mail. A web site will be maintained and regularly updated as needed, preferably at least monthly.	We maintained our filing system and used our web site as the primary means of giving access to the public. We responded to some 100 telephone calls from the public and 440 emails, faxes and letters. We retained a part-time contractor to organize and maintain our public correspondence on an internet server in all-electronic form to both the Commissioner and Deputy Commissioner.	
5.2	52	Publish decisions determinations orders proceedings		
		The Commissioner will publish every decision, determination and order in a manner that the Commissioner believes will bring it to the attention of the public. All such items will be published on the Commission's website, at a minimum.	We published all decisions, determinations and orders on our web site with explanatory text, and included question-and-answer sheets as required.	
5.3	NA	Communicate with public and stakeholders		
		The Commission will actively communicate the role and responsibilities of the Commission to the public; make appearances in the media; make presentations and speeches to stakeholder groups.	During the year, we attended meetings with the public and stakeholders as follows: Ferry Advisory Committee (FAC) for Quadra Cortes (two occasions, including one speech); management of Seaspan Intermodal; BC Trucking Association; Deputy Minister of Transport and his staff; BC Ferries Annual Public Meeting; BC Ferries Board of Directors with formal remarks. We were interviewed some 6 times by the broadcast media and on several occasions by print media.	
6.0		**Administration and Reporting**		
6.1	36	Operate office and engage external support services		
		Operate the office of the Commission. Maintain arrangements for telephone, mail and electronic access. Rent office space as required. Office operations (secretarial, phone, courier, post, internet, website) Office equipment dedicated to Commission use. Work with Office of the Attorney General as provider of payment system on behalf of the Commission. Obtain internal bookkeeping, archiving, and legal services as required.	We operated a virtual office. Our accounting and payment system was provided by Office of the Attorney General at no charge to the Commission. We did not engage independent legal advice during the year. We engaged a contractor to develop our communication and outreach plans and to assist with public correspondence.	
6.2	NA	Research background to ferry operating environment		

		Issue orders for non-compliance with the legislation as necessary	No activity was necessary.
5.1	52	Maintain Commission records, provide public access	
		Files will be maintained accessible to the public under the Freedom of Information and Protection of Privacy Act. Response to public enquiries will be made via telephone, postal mail, e-mail. A web site will be maintained and regularly updated as needed, preferably at least monthly.	We maintained our filing system and used our web site as the primary means of giving access to the public. We responded to some 100 telephone calls from the public and 440 emails, faxes and letters. We retained a part-time contractor to organize and maintain our public correspondence on an internet server in all-electronic form to both the Commissioner and Deputy Commissioner.
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		Operate the office of the Commission. Maintain arrangements for telephone, mail and electronic access. Rent office space as required. Office operations (secretarial, phone, courier, post, internet, website) Office equipment dedicated to Commission use. Work with Office of the Attorney General as provider of payment system on behalf of the Commission. Obtain internal bookkeeping, archiving, and legal services as required.	We operated a virtual office. Our accounting and payment system was provided by Office of the Attorney General at no charge to the Commission. We did not engage independent legal advice during the year. We engaged a contractor to develop our communication and outreach plans and to assist with public correspondence.
6.2	NA	Research background to ferry operating environment	

		This activity is Commissioner's ferry system familiarization and background study. The Commissioner intends to travel all ferry routes in person. Research and Investigations initiated by Commission.	During the year the Commissioner and Deputy Commissioners traveled some 12 of BC Ferries 25 regulated routes.
6.3	69	Prepare Commission's annual budget	
		Budget will include expenditures reasonably expected to be incurred in the following year, supported by a Service Plan for the year.	We prepared our Annual Service Plan and Budget for FY 2007/8. We submitted it to the Minister and BC Ferries by September 30 2006 as required.
6.4	53	Report annually to Lieutenant-Governor in Council	
		Within 4 months after the end of each fiscal year, the Commissioner will make a report to the Lieutenant-Governor in Council for the preceding fiscal year, setting out briefly (a) all applications and requests for decisions to the commissioner under the Act, (b) all orders issued by the commissioner, (c) the financial statements applicable to the office of the commissioner for that year along with full disclosure of the expenses of, and associated with, the office of the commissioner, and (d) other information the Lieutenant-Governor in Council directs.	We submitted our FY 2005/6 Annual Report to the Lieutenant-Governor in Council by July 31 2006 as required.

5 Average Fare Levels

The table below shows the values of a price cap index (=100 at 2003) and compared to an index of actual weighted average fares, for each of seven groups of routes in the BC Ferries system.

The figures are computed by methods laid down in Commission Order 05-01. They exclude extraordinary increases allowed in fiscal 2006/7 due to high fuel prices, which are separately measured and tracked.

Note that BC Ferries is allowed to exceed the price cap index for one (in highlighted boxes), but not two, consecutive quarters under the regulation.

These figures confirm that BC Ferries was in compliance with price caps in fiscal 2006/7.

Average Fare Index Summary

Route Group		Jun-2005	Sep-2005	Dec-2005	Mar-2006	Jun-2006	Sep-2006	Dec-2006	Mar-2007
#1: Majors									
	Cap	**104.48**	**105.25**	**106.35**	**106.60**	**107.37**	**108.40**	**109.06**	**109.58**
	Actual	104.25	105.11	106.32	[illegible]	106.92	[illegible]	108.55	109.33
#2: Route 3									
	Cap	**107.21**	**108.79**	**110.22**	**110.63**	**111.91**	**113.42**	**114.46**	**115.39**
	Actual	105.45	106.65	108.30	109.04	110.13	111.61	113.30	114.93
#3: Northern									
	Cap	**106.21**	**108.86**	**109.46**	**109.69**	**111.00**	**113.60**	**114.13**	**114.71**
	Actual	105.25	107.44	107.78	108.12	108.49	101.91	104.28	104.58
#4: Route 40									
	Cap	**105.22**	**108.99**	No Service		**109.96**	**113.79**	No Service	**108.99**
	Actual	102.44	[illegible]			107.17	[illegible]		[illegible]
#5: Route 12									
	Cap	**107.15**	**108.85**	**110.02**	**110.49**	**111.57**	**113.34**	**114.36**	**115.27**
	Actual	96.18	107.35	106.06	106.61	107.17	108.67	110.67	112.20
#6: Minors									
	Cap	**107.13**	**108.77**	**110.20**	**110.56**	**111.78**	**113.47**	**114.43**	**115.33**
	Actual	105.51	107.29	107.06	106.78	106.97	108.44	109.66	115.21
#7: Route 13									
	Cap	**107.29**	**108.68**	**110.00**	**110.66**	**111.16**	**113.70**	**114.27**	**115.14**
	Actual	98.71	102.49	103.01	102.72	[illegible]	106.40	111.90	[illegible]

6 Financial Statements

Accounting Services

The Commission is grateful for the assistance of the Ministry of the Attorney General which provides accounting, banking and payment services at no cost to the Commission. These financial statements are based upon the financial information provided by the Ministry.

Summary Financial Statements

BC Ferries Commission
Summary Financial Statements

	In $ thousands		
	2006/07		2005/06
	Budget	Actual	Actual
Statement of Operations			
Revenues	437	237	214
Expenditures			
Operating Costs	437	280	203
Surplus(deficit)	0	-43	11
Change in Net Assets			
Opening balance		89	78
Surplus(deficit)		-43	11
Net Assets end of year		46	89

Revenues

Revenues consist of a percentage levy on toll revenues from ferry operators. In fiscal year 2006/7, the total paid to the Commission by BC Ferries, the only ferry operator regulated by the Commission during the year, was $237,000.

Expenditures

Expenditures in fiscal 2006/7 were $280,083. Expenditures were for Commissioners fees and expenses and for the cost of consultants engaged to assist and advise the Commission.

The cost of operating the Commission represented 0.08% of BC Ferries' toll revenue (i.e. excluding retail and other ancillary revenue and service fees) for fiscal 2006/07, or about 40% of the maximum 0.20% of toll revenues allowed to the Commission by the Act in any year in which there

is activity under section 40 of the Act (establishment of price caps for the second performance term).

Commissioner Remuneration

The Commissioner and Deputy Commissioner are paid a per-diem fee for their services. The Commissioner received $129,937 in fees during the year. In addition he was reimbursed $10,051 for expenses incurred during the year, including travel, dedicated office equipment, office supplies, telephone, web site and other communications expenses. The Deputy Commissioner received $35,912 in fees for his services and he was reimbursed $979 for travel and other expenses incurred in the period.

Net Assets

The difference between the amounts received from ferry operators and expenditures is carried forward for use in the next fiscal year. $46,633 was carried forward into fiscal 2007/8. The Net Assets of the Commission are included in the Financial Statements of the Province of BC.